

COMMITTEE ON GOVERNMENT REFORM  
SUBCOMMITTEE ON ENERGY AND RESOURCES



*OPENING STATEMENT OF  
CHAIRMAN DARRELL ISSA*

Oversight Hearing:

***“Deep Water Royalty Relief: Mismanagement and Cover-ups”***  
*June 21, 2006*

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First I would like to thank the witnesses for appearing today. Your willingness to answer questions is an important step in this investigation.

This Subcommittee is investigating the absence of price thresholds in deepwater leases entered into during 1998 and 1999. The results to date indicate a trail of gross mismanagement by the Department of Interior.

This irresponsibility will cost the taxpayers almost \$10 billion.

In 1995, Congress enacted the Deep Water Royalty Relief Act to provide financial incentives to companies to produce oil and natural gas from our deep coastal waters. This came at a time when oil and natural gas prices were low and the interest in deepwater drilling was lacking.

As an incentive, the Act allowed oil and gas companies to forego paying royalties to the Department of Interior for a specific volume of oil or gas produced. This would allow companies to recoup their capital investment before having to pay royalties. I repeat: the purpose of the royalty suspensions was to allow companies to recoup their capital investment!

To ensure that companies did not receive windfall profits, the Act also provided for price thresholds. In other words, a company would be allowed to operate royalty-free until either a certain volume of production was achieved, or the market price for oil or gas reached a specified ceiling. These two provisions are known as volume suspensions and price thresholds, respectively.

The Interior Department was charged with the Act’s implementation. As such, it was to issue a rule devising a royalty suspension scheme that would impose volume suspensions and price thresholds.

The interim rule issued on March 25, 1996 by the Interior Department was inadequate. It did not contain price thresholds. Instead, the final notices of sale contained volume suspensions and

price thresholds, and leases signed in 1996 and 1997 included volume suspensions and price thresholds in addenda to leases. *[These are illustrated on the screens in Exhibit 1, the Final Notice of Sale, and Exhibit 2, a lease addendum]*

This practice continued until the final regulation was issued in January of 1998.

For leases issued in 1998 and 1999, the price thresholds disappeared from the Final Notices of Sale and individual leases.

Instead, these documents referred to a Final Rule—30 CFR Part 260—regarding the royalty relief program. The Final Rule was printed in the Federal Register in January 1998. The bottom line is that this rule only contained volume suspensions and did not contain price thresholds. *[See Exhibit 3 on the screens]*

Had the price thresholds been included in leases in 1998 and 1999, the threshold would have been set at about \$28 per barrel of oil, and \$3.50 per thousand cubic feet of natural gas. I don't need to do the math for you.

In a previous hearing before this Subcommittee, a senior career official claimed that employees thought the Final Rule contained price thresholds and operated under that assumption, and that is why the lack of price thresholds in the leases themselves did not trigger red flags. How this could have happened is a mystery since both the Interim and Final Rules never contained price thresholds. *[See Exhibit 4 on the screens]*

Every one of these actions survived multiple levels of legal and bureaucratic scrutiny. In fact, the lawyers who drafted and approved the interim regulation were the same lawyers who drafted and approved the final regulation and every final notice of sale.

The terms and conditions in the leases were to be a carbon copy of those advertised in the final notices of sale.

I heard that this was explained as a case of “the right hand did not know what the left hand was doing.” But it must be unique in that the right and left hand were, in fact, working on the same computer keyboards and at the same desks in the Interior Solicitors' Office. I hope to hear a better explanation today. *[See Exhibit 5 showing the witnesses roles in rule-making and lease sales]*

The Department has also testified, under oath, that nobody noticed the lack of price thresholds until early 2000. I am extremely skeptical for the following reason.

The documents suggest that someone noticed the problem and attempted to fix it, but did it wrongly. The sale notices were different in 1998 than they were in 1999. In 1998, the sale notices make reference to 30 CFR Part 260.

In 1999, somebody within the Department changed the language to reference 30 CFR Part 203, which contains both volume suspensions and price thresholds. However, Part 203 only applies to pre-1995 leases. Thus, the change had no effect. The leases were operationally no different than before the change in the sale notice. *[See Exhibit 6 on Part 203, which clearly shows it was for pre-November 1995 leases. See Exhibit 7 for the “Surname” Sheet for the same sale. Note that besides our witnesses signatures, in the red box, there are at least 9 others who reviewed the document]*

I am well aware that for every decision made by an agency, there is a corresponding decision memorandum. We have asked for decision memoranda concerning all the Department’s decisions regarding the drafting of the regulations, lease sales, and lease approvals.

We have not received any memoranda specifically referencing the exclusion of price thresholds in the regulations, nor have we received any memoranda regarding the decision to switch the reference in the sale notices from Parts 260 to 203.

Again, many people are involved at every step of the leasing and rulemaking process. Lawyers, experts, and management, at least up to the Assistant Secretary level, are obligated to review and sign off on every phase.

The fact that nobody raised an issue with the lack of price thresholds for years leads to one of two conclusions: nobody reviewed the leases and regulations, or everyone reviewed and knowingly approved the faulty leases and regulations. Either scenario is unacceptable. *[See Exhibit 8 that shows the number of people involved in the rulemaking and approval process]*

Our first panel of witnesses includes current and former attorneys for the Department of Interior who will help us get to the bottom of the missing price thresholds. Our second panel represents the oil and gas producers who have the most leases from the 1998 and 1999 period.

I realize that companies are expected to maximize shareholder value. At the same time, shareholders expect companies to operate on the “up and up” and to avoid surprises that may affect earnings.

I am sure that at least some oil and gas producers noticed that price thresholds were missing in the Final Notices of Sale and the first leases executed in 1998. They must have known that the missing price thresholds would eventually cast doubt on the validity of the leases. It is difficult to believe that no one brought this to the attention of the government.

My question to these companies is this: *“If there is a bank error in your favor—which you immediately notice—do you bring it to the bank’s attention, or do you hope no one finds the error and instead assemble a legal team to later claim these gains are yours to keep?”* Bear in mind that this sum is about \$10 billion and is, in fact, the people’s money. These royalties are collected on resources that belong to the American people. The American people are not getting the return that Congress promised them they would get.

The Interior Department's Inspector General's Office has been conducting a parallel investigation surrounding the same issues. They have conducted 27 interviews thus far, of attorneys in the Solicitor's Office and present and former MMS officials in the DC area and New Orleans. They have reviewed thousands of documents, including 5,000 e-mails, and expect to conduct additional interviews. The IG's Office expects to issue a report within six to eight weeks.

I ask for unanimous consent that a letter from the IG providing the status of their investigation be inserted into the record, and the briefing memo prepared by the Subcommittee staff be inserted into the record, as well as other relevant materials.

I have one last comment before I introduce the first panel of witnesses. It is really a public request. I would ask that anyone watching or listening to this hearing, and who may have additional information regarding the missing price thresholds in 1998 and 1999, please contact the Subcommittee and its staff.

Today our first panel consists of current and former Interior Department attorneys. They were responsible for review of the leases and regulations, so they should be very helpful in shedding light on how these errors occurred.